THAI ECONOMY IN THE ASEAN CONTEXT [*]

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1. Introduction

Apart from the handover of Hong Kong from Great Britain to China on July 1, 1997, another event in late July of the same year promises to be recorded as one of the most important in the modern history of East Asia. This is the formal admittance of three new countries in Southeast Asia as members in the 30-year-old Association of Southeast Asian Nations or ASEAN. These three countries are Cambodia, Lao PDR and Myanmar. This event has come about after much debate within the ASEAN itself as well as among interested and concerned countries around the world: interested because ASEAN has become one of the most successful regional grouping in the world today, and whatever it does collectively as a group commands attention; concerned because there are many reservations and unanswered questions about these three new members that by having them as full-fledged members of ASEAN may either connote some unwarranted political compromises, or jeopardise the stability of future ASEAN.

This paper will not be discussing political aspects and implications of such move by ASEAN leaders. It will instead look at some of the economic arrangements that ASEAN members have agreed to follow, the economic changes that have taken place or will be taken place in the near future, all of these by using Thailand as a focal point or a study case. In other words, this paper will discuss the Thai economy in the context of a rule-abiding member of ASEAN. It will attempt to show how Thailand has prepared its economy for a higher form of economic cooperation in this region, the problems that it faces while doing so, and how it solves or tries to solve those and other related or associated economic problems in the globalised 21st century. Section 2 briefly describes the structure of the Thai economy and the current economic problems it is facing. Section 3 discusses the main features of economic cooperation under ASEAN framework, whereas in Section 4 we will discuss a few policy responses to such ASEAN principles by the Thai authorities. Finally, Section 5 concludes and offers some observations on what lessons could be learned from the Thai experience as a member of ASEAN.

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2. Structure of the Thai Economy in a Nutshell

Thailand was a low income, low growth economy at the end of the 1950s. Close to 85 per cent of the total population were engaged in agriculture of which rice was the major agricultural product. Its main exports consisted of rice, rubber, teak and tin. Then its leaders decided to move the country quickly along the path of modern economic development emphasising import substitution and later export promotion. With the help of the World Bank in preparing its first national economic development plan, Thailand adopted market approach to economic development, that is to say, it allowed the private sector to initiate their own investments with the government taking essentially non-interventionist approach but providing necessary incentives and basic infrastructure, legal and business frameworks.

Thailand today is a middle-income, developing economy. It has come this far through agricultural diversifications where several more crops such as maize, cassava, sugarcane were added to the list of agricultural expansion and exports. Import substitution industrialisation started with textile and consumer products, then moved up to garments, electrical appliances, electronic components, processed food, and jewellery. While the majority of the population is still engaged in agriculture (about half in 1996), the contribution of agriculture to GDP has fallen from about 40 per cent at the launch of Thailand's first national economic development plan in 1961 to about 10 per cent today, while manufacturing has increased its share from about 8 per cent to 30 per cent during the same time period. The services sector has remained relatively unchanged around 50 per cent. The rest of GDP is made up of contributions from other industrial activities such power and utilities, and transportation.

Three major factors helped explain the rapid economic growth of the Thai economy in the latter half of the 1980s: the extraordinary increase in exports after devaluation of the baht in 1984; the increase in (the second wave of) foreign direct investment from Japan after the Plaza Accord in 1985, and the increase in earnings from foreign tourists from 1987. The country has begun to suffer from shortage of infrastructure prompting the government to play much greater role in the provisions of infrastructure, the role made possible by the fiscal surplus in a booming economy. The strength of the economy also enabled the Thai authorities to liberalise its financial system quickly, opening the country to more competition (and higher risk) from abroad. The growth of the economy raised the average income of the

people across the board, resulting in drastic reduction in the incidence of poverty to around 10 per cent in 1994.

Thailand suffered domestic political turmoil in 1991 and again in 1992 which saw its growth slowed. The problems erupted again in 1996 in the aftermath of serious floods throughout most parts of the country, when the inflation soared past 7 per cent, its exports failed to increase due to the loss of comparative advantage in low-cost manufacturing products, its current account deficits worsened to about 8.5 per cent of GDP, and its property market in trouble after too aggressive expansion in the late 1980s. The slowdown in export growth in 1996 and the first quarter of 1997, coupled with the financial difficulties of many banks and finance companies put a great deal of pressure on the Thai monetary and fiscal authorities to maintain economic stability, and erode the confidence of investors, domestic as well as foreign. The continued high level of current account deficits also put pressure on the exchange rate of the baht which was effectively fixed with the US dollar. Many speculative attacks on the baht convinced the government leaders that the defence of the baht fixed exchange rate with the US dollar was untenable. This led to the flotation of the baht in early July 1997 which immediately saw the devaluation of the Thai baht by about 15 per cent. The ensuing inflation may come back to haunt the Thai economy again after the authorities have maintained the price increase in 1997 to about 4.5 per cent. It may take Thailand a few years to restructure its economy and move back on its high growth path again.

3. **Principles of ASEAN**

Thirty years ago in 1967, foreign ministers of five Southeast Asian countries, namely Indonesia, Malaysia, Philippines, Singapore and Thailand, met in Bangkok to sign the Bangkok Declaration setting up the Association of South East Asian Nations or ASEAN. There were several reasons that brought these five nations together to form this economic grouping, but two of the most important could be that, firstly, this was an attempt by these countries to resist the economic and political powers of other countries within and outside the region, and secondly, they wanted an effective organisation that would help solve or mediate conflicts between member countries. From these reasons, it appeared at first that ASEAN would be more a political grouping than an economic grouping, which was correct. But these leaders had learned of the failure of such political groupings in the past, so this time they tried to avoid it by specifically designating ASEAN an economic grouping. Because of similarities in these ASEAN countries with regards to their agricultural orientation (with

the exception of Singapore), there were little scope for economic cooperation in terms of increased trade and investment. It took ASEAN almost 20 years to become more engaged in economic cooperation in terms of greater intra-ASEAN trade and investment. But then this new found relationship took off and accelerated, culminating in member countries trading and investing in one another in differentiated manufacturing products and also traditional agricultural products.

We will not be paying too much attention to the development of ASEAN economic cooperation during the first two decades of its existence because there was not much development deserving our special attention. Suffice it to say that ASEAN leaders tried to maintain the momentum of interest among member countries, waiting for the right time for breaking through. At least the first ASEAN Summit of heads of government in Bali in 1986 led to the setting up of the Agreement on ASEAN Preferential Trading Arrangements or ASEAN-PTA, the backbone of ASEAN trade liberalisation policy then, and the ASEAN Industrial Cooperation (AIC), the joint investment program of ASEAN members. Not much progress had taken place in increased intra-ASEAN trade and investment during the second decade of ASEAN, although there were various attempts to revitalise ASEAN economic cooperation through changes in trade and investment agreements among ASEAN members (such as the installation of the more flexible ASEAN Industrial Joint Venture or AIJV program at the Third ASEAN Summit in Manila in 1987). It was not until the Fourth Summit of ASEAN heads of government in Singapore in January 1992 that ASEAN economic cooperation has really entered a new chapter.

And Thailand had played a crucial role in that summit in 1992. It was the initiatives of the then Thai prime minister Mr Anand Panyarachun which called for the setting up of the ASEAN Free Trade Area or AFTA by the year 2008. All other ASEAN economic leaders agreed, and the Singapore Declaration of 1992 was proclaimed, officially giving birth to the AFTA movement. Of course numerous ground works and consultations were undertaken by Thai high-ranking officials prior to that Summit, with agreements from senior officials from other ASEAN member countries, and the blessings from their leaders. The new backbone of this AFTA movement is the Agreement of the Common Effective Preferential Tariff (CEPT) Scheme which calls for the successive reduction of tariffs in commodity trade among ASEAN members from the existing levels to no more than 5 per cent by the year 2008. For a special group of 15 products, the reduction to 0-5 per cent would even be faster by the

year 2003. [1] Two years later, the deadline for the full operation of AFTA was moved up five years sooner, that is to say, for the so-called normal track products, the tariff reduction to 0-5 per cent must be achieved by the 2003, and for the special, 15 fast-track products, the reduction of tariff to 0-5 per cent must be achieved by the year 2000. Underneath all these specific agreements, the usual fair trade practices such as most-favoured-nations (MFN) treatment, national treatment, and transparency measures apply to all ASEAN transactions and activities. [2]

The investment cooperation in ASEAN has also changed. The AIJV which was in operation since 1987 was first supplemented by the so-called Brand-to-Brand Complementation (BBC) Scheme in 1988. [3] As a result of an ASEAN Ministerial Meeting in Singapore in 1996, a new industrial cooperation scheme was launched, replacing the AIJV and BBC. This new scheme is called the ASEAN Industrial Cooperation Scheme or AICO. It is an improvement over previous industrial cooperation in the sense that only two companies in two different ASEAN countries can enter into an 'AICO Arrangement' whereby the product or output of participating companies will enjoy a preferential tariff rate of 0-5 per cent now instead of having to wait until the year 2000 or 2003. The preferential tariff rate will also apply to the importation of intermediate products and/or raw material inputs for the manufacture of an AICO final product and/or AICO intermediate product. This is indeed a generous scheme and should generate vast interest among manufacturing firms within ASEAN.

The CEPT and AICO at present form a major part of ASEAN economic cooperation framework, but ASEAN economic cooperation has gone beyond this formalised trade and investment liberalisation. The foundation of ASEAN economic policies is similarly anchored in the principle of free and open trade as evidenced in a clause in the Singapore Declaration of 1992 which said: "ASEAN shall continue to uphold the principle of free and open trade embodied in the General Agreement on Tariffs and Trade (GATT), and work towards

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[1] These 15 products are: (1) vegetable oils; (2) cement; (3) chemicals; (4) pharmaceuticals; (5) fertiliser; (6) plastics; (7) rubber products; (8) leather products; (9) pulp; (10) textiles; (11) ceramic and glass products; (12) gems and jewellery; (13) copper cathodes; (14) electronics; and (15) wooden and rattan furniture.

[2] Of course the CEPT agreements allow for several exceptions and exemptions from normal tariff reductions such as the use of exclusion list of sensitive products that the country would like to see exempted or delayed from tariff reduction.

[3] This was a scheme whereby several automotive companies in ASEAN agreed to produce given automotive parts for different brands of cars in one ASEAN country in exchange for other automotive parts produced in other ASEAN countries. This was one of the measures to reduce production costs on the principle of division of labour and economies of scale.

maintaining and strengthening an open multilateral trading system". In fact, this is the principle that the new regional grouping, the Asia Pacific Economic Cooperation or APEC, has adopted, strengthening the position of ASEAN in its participation in APEC. [4] Also as part of an increasingly interdependent world, ASEAN has continued to intensify its cooperative relationships with its Dialogue Partners, namely Australia, Canada, the European Community, Japan, Korea, New Zealand and the United States, and engage in consultative relationships with interested non-Dialogue countries and international organisations.

4. **Thai Policy Responses**

As an export-oriented economy, Thailand is naturally bound by an established free-trade principle to support such economic grouping as ASEAN and APEC. This does not mean however that Thailand stands to gain in every way as a consequence of following the free trade regime in its general economic policy. Thailand is still a developing economy where some of its economic institutions still not developed enough to withstand rapid changes brought about by economic liberalisation. There are several questions of concerns that Thai authorities may wish to express with respect to the decision to join the regional groupings such as ASEAN or APEC, questions such as: Would such economic cooperation benefit Thailand? What impacts will it have on local or domestic economy? What else needs be done to enjoy the benefits of such economic cooperation? And so on. These questions may be addressed in turn.

(a). The benefits of greater intra-ASEAN trade

A standard trade theory stipulates that economic integration may bring beneficent effect of trade creation or detrimental effect of trade diversion depending on the nature of economies of trading or economic partners. If integrating economies are producers of different or differentiated commodities, the economic integration could bring in complementarity in their mutual trade leading to higher trade benefits, but if integrating economies are producers of the same commodities, then there are little opportunities for them to increase trade among one another. It was afraid that since most ASEAN economies (with the exception of Singapore) are basically agricultural economies (at least until the end of the 1980s anyway), the trade creation benefits from forming economic grouping to trade more freely among one another would not be that great.

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[4] ASEAN countries wanted to make sure that APEC would not turn into a discriminating trade bloc and had set this free and open trade as a condition for its participation in APEC. This ASEAN condition is known as the Kuching Consensus which came out from a ministerial meeting in Kuching, Sarawak in 1992.

This, however, has been proven wrong. The rapid industrialisation of ASEAN countries in the last two decades have brought about different manufacturing as well as processed agricultural products so that during the last one and half decades, trade among ASEAN partners expands substantially. The gains from trade are obvious from industrial restructuring and more efficient industrial production. Several empirical studies have shown this to be the case. A study by Menon (1996) on the dynamics of intra-industry trade in ASEAN, for example, shows that not only the intra-ASEAN trade has increased, such growth in intra-ASEAN trade has brought about an increase in the intra-industry trade (IIT) growth. What this means is that to the extent that there is some degree of industry-specificity in the employment of factors, their reallocation between activities or product lines within industries is likely to incur lower costs than their reallocation between industries. In other words, both labour and capital are likely to adapt more easily to a new environment where the change is a result of increased intra-industry rather than inter-industry specialisation. Menon therefore supports Paul Krugman's idea that adjustment costs under the above situation may be lower because it is possible for all factors to gain from trade in an intra-industry setting. Based on the results of his study, Menon concludes that it is reasonable to expect that IIT will continue to grow in importance as ASEAN countries continue to industrialise and pursue more liberal trading regimes, and thus much of the concern that threatens the viability of AFTA may be misplaced.

International trade statistics of Thailand has shown very conclusively that the importance of its trade with ASEAN partners has increased enormously in the last few years. As shown in Table 1 (and Chart 1), the share of Thai exports to ASEAN in 1995 was 19.07 per cent compared to 19.01 per cent to the NAFTA market (including the US, Canada and Mexico), 16.79 per cent to Japan, and 14.53 per cent to the European Union. The growth rate of exports to ASEAN is also very high, averaging 32.92 per cent per annum during 1991 to 1996. Only the growth rate of Thai exports to Indochina countries is larger at 73.62 per cent per annum. Considering the fact that these Indochina countries will soon become ASEAN members, the figure for Thai exports to ASEAN in the future will enlarge substantially.

(b). The impacts of ASEAN economic cooperation

At least one concern has been disposed of, but a more specific concern about across-the-board tariff reduction in future ASEAN trade may still linger on. Again several empirical studies on the effects of trade liberalisation (including tariff reduction) on domestic economy have shown that trade liberalisation would help rather than hurt

domestic economy in the long run. For example, a study by Wisarn *et al.* (1994) has shown that the customs tariff reduction of Thailand in the AFTA agreements will be beneficial and not detrimental to the Thai economy. Wisarn *et al*. used a computable general equilibrium (CGE) simulation model to measure the change in volume and value of net exports and the associated change in capital investment. A major finding of Wisarn *et al*. is that the customs tariff reduction of Thailand in the AFTA context will lead to the increase of Thai exports to both ASEAN and non-ASEAN countries due mainly to the reduction in the cost of manufacturing production, and this will lead to an eventual increase in foreign and domestic investments leading to further increase in exports. This increase in exports is true even the customs tariff reduction is carried out unilaterally without corresponding reductions from its ASEAN members. And the increase in exports is not only limited to ASEAN countries only but to non-ASEAN countries as well. [5]

As the initiator of AFTA, Thailand will continue to be praised for its forward-looking and path-breaking move. However, the fact remains that the average customs tariff rate in Thailand at the time of the AFTA proposal was highest among ASEAN countries and still is today. The Thai government has promised to abide by the timetable of tariff reduction as spelled out by the AFTA Agreement so that by the year 2000, all the fast-track commodity items will have a tariff rate of at most 5 per cent, and for normal-track commodity items, the same rate will be achieved by the year 2003. Table 2 shows how the timetable of tariff reduction in Thailand from 1993 to 2003. [6]

(c). Other liberalisations in the ASEAN framework

As mentioned earlier, tariff reduction is the backbone of ASEAN economic cooperation, but tariff reduction is but one economic measure that forms a larger part of economic reforms and liberalisation. In the present globalised world where countries must compete economically with one another to survive and prosper, economic reforms and liberalisation are a must. Thailand is no exception. It is fortunate that all ASEAN members are proponents of free market, and all have undertaken necessary economic reforms to free their economies from economic distortions and inefficiencies.

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[5] However, these effects occurred under the assumption of long-run closure, that is to say, the model allows the economy to adjust along with the growth in capital stock as a result of tariff reduction. In other words, tariff reduction allows change in capital investment. If this assumption is dropped, that is when the short-run closure is assumed, the beneficial effects of customs tariff reduction are much reduced.

[6] It appears, however, existing economic conditions may dictate otherwise. That is to say difficulties in balance of payments may force the Thai government to increase customs tariffs of some import items either to increase government revenues or to continue its industrial protection.

These practices act as peer pressure to all ASEAN members to keep up their reform efforts.

For Thailand, the structural adjustments of the economy began in the middle of the 1980s when the country experienced economic slowdown and difficulties in its external sector, as mentioned earlier. Distorted prices were corrected and efficient subsidies and protections reduced. When economic health returned towards the end of the 1980s, the government leaders felt confident enough to begin financial liberalisation. Bank of Thailand first began to lift interest ceiling, then deregulate exchange control, ease the control on assets management of financial institutions, open off-shore banking facilities, improve the standards of financial institutions, develop new financial instruments, encourage greater competition among commercial banks and between commercial banks and finance companies, and try to develop Thailand into a regional financial centre. [7] These liberalisation efforts have made the Thai financial market stronger and more efficient, and should serve the Thai economy well in its future economic development. [8]

As countries in former Indochina region will become ASEAN members soon, the subject of the use of Thai baht as the subregional currency has become relevant. It was argued elsewhere (such as in Medhi, 1997) that the benefits of increased use of the baht in the Indochinese region from the point of view of Thailand are quite obvious. First of all, trade and investment between Thailand and its Indochinese neighbours are expected to increase because the need to use convertible currencies which are scarce in many of these Indochinese countries is substantially removed. Secondly, the cost of foreign-exchange purchase and the risk of exchange-rate fluctuation from the point of view of Thai businessmen are reduced, providing an additional competitive edge to Thai businessmen. Thirdly, as it has been projected that the balance of trade between Thailand and its Indochinese neighbours will be against Thailand in the future, the use of baht will help reduce the pressure on Thailand's international reserves, at least in the short-run. Fourthly, the use of baht will have a direct link with domestic (Thai) production of goods and services helping local economy. And finally the use of baht give seigniorage gains to Thailand similar to the lending of these Indochinese countries to Thailand without charging interest.

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[7] For details on different plans of financial liberalisation in Thailand, see, for example, Medhi (1997).

[8] For an empirical study that shows that financial liberalisation leads to domestic financial market becoming more open and more efficient, see Ariff (1996).

But there are also some costs involved in the increased use of the baht outside Thailand. Firstly, it will be more difficult to project the demand for money and to control money supply because of the change in the behaviour of the demand for money. [9] Secondly, when the demand for the baht increases, the supply of the baht will also increase, putting pressure on the current account balance and inflation. Thirdly, the rush to convert the baht to foreign currencies in the manner which is detrimental to the international reserve position of Thailand could take place when there is a loss of confidence in the Thai baht. Therefore, there is an added pressure on the Thai authority to maintain the stability in the financial system of Thailand. The recent financial difficulties of Thailand which forced the government to float (devalue) the Thai baht may act as a brake to the idea of further developing the so-called Baht Zone because the Thai economy may not be strong enough to face wide-open international trade and finance regime.

5. **Conclusions: What Lesson May Be Learned?**

It may be concluded that the experience of Thailand as a member of ASEAN points to the necessity of trade and investment liberalisation as a precondition for a successful economic grouping that stresses long-term economic growth and efficiency. These liberalisation efforts which include tariff cuts and freer flows of trade and investment across border work even in the context of unilateral action, that is to say, trade and investment liberalisation without reciprocity. Unilateral actions of course induce free-rider problems, but it is the free riders who fail to open up and make necessary economic adjustments who will suffer the consequences of inefficiency at the end. This spirit of unilateral trade and investment liberalisation (despite the immediate objective of forming a free trade area in Southeast Asia) could be considered the hallmark of ASEAN economic cooperation, which in fact has permeated into Asia Pacific Economic Cooperation or APEC. This economic openness and free competition should make ASEAN an example of desirable economic grouping for many other countries in other region and in the world.

[9] However, under the present exchange rate system, it is already difficult to control the money supply due to its effect on the change in the international reserves. Therefore, even if the authority could estimate the demand for money (in this case, demand for baht) accurately, it is still difficult to control the money supply.

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Table 1: Exports of Thailand by Country of Destination (Amount in baht: million)

	1991	1992	1993	1994	1995
Amounts					
Japan	131,052	144,393	159,479	194,274	236,101
NAFTA	166,872	198,991	217,582	256,204	267,278
EU	150,121	161,350	155,978	169,385	204,312
ASEAN	85,921	104,826	145,209	200,570	268,192
Indochina	4,124	8,738	15,740	26,254	37,469
Middle East	37,510	39,016	42,586	42,046	63,863
Eastern Europe	12,313	10,543	13,448	12,136	16,796
Others	137,717	156,786	185,840	236,731	312,300
Total	725,630	824,643	935,862	1,137,600	1,406,311

	1991	1992	1993	1994	1995
Share					
Japan	18.06	17.51	17.04	17.08	16.79
NAFTA	23.00	24.13	23.25	22.52	19.01
EU	20.69	19.57	16.67	14.89	14.53
ASEAN	11.84	12.71	15.52	17.63	19.07
Indochina	0.57	1.06	1.68	2.31	2.66
Middle East	5.17	4.73	4.55	3.70	4.54
Eastern Europe	1.70	1.28	1.44	1.07	1.19
Others	18.98	19.01	19.86	20.81	22.21
Total	100.00	100.00	100.00	100.00	100.00

	1991	1992	1993	1994	1995	1991-1995
Growth rate						
Japan		10.18	10.45	21.82	21.53	15.85
NAFTA		19.25	9.34	17.75	4.32	12.50
EU		7.48	-3.33	8.60	20.62	8.01
ASEAN		22.00	38.52	38.13	33.71	32.92
Indochina		111.88	80.13	66.80	42.72	73.62
Middle East		4.01	9.15	-1.27	51.89	14.23
Eastern Europe		-14.38	27.55	-9.76	38.40	8.07
Others		13.85	18.53	27.38	31.92	22.71
Total		13.65	13.49	21.56	23.62	17.99

Source: Bank of Thailand, *Monthly Bulletin*, December 1996.

Chart 1: Share of Thai Exports by Country of Destination

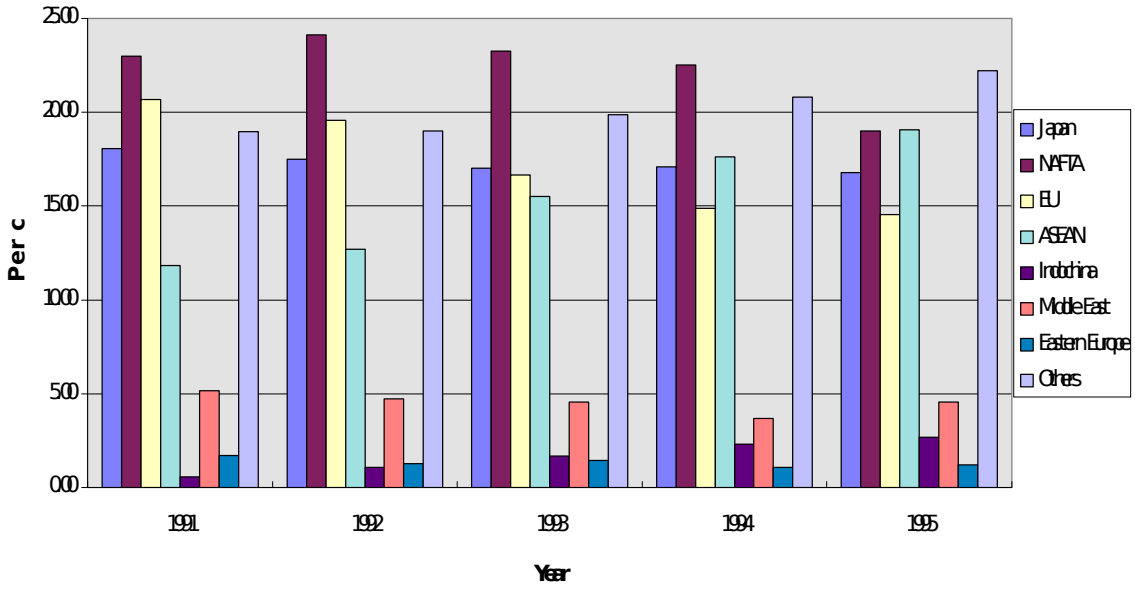

Table 2: Tariff Reduction Plan of Thailand, 1993-2003

Starting rate	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*
Fast Track											
Greater than 30%	30	30	25	25	20	15	10	5			
26-30%			25	25	20	15	10	5			
21-25%			20	20	15	10	5	5			
16-20%			15	15	10	5	5	5			
11-15%			10	10	5	5	5	5			
6-10%			5	5	5	5	5	5			
5% and under											
Normal Track											
Greater than 30%	30	30	30	25	25	20	20	15	15	10	5
26-30%				25	25	20	20	15	15	10	5
21-25%				20	20	15	15	10	10	5	5
16-20%				15	15	10	10	5	5	5	5
11-15%				10	10	5	5	5	5	5	5
6-10%				5	5	5	5	5	5	5	5
5% and under											

Source: Fiscal Policy Office, Ministry of Finance